An Analysis of Western Massachusetts Electric Company

January 2007 Rate Increase and Compliance with the 2006 Settlement

Commonwealth of Massachusetts

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I. Introduction

In early 2007, large commercial and industrial customers in Western Massachusetts Electric Company's (WMECo or the "Company") service territory began noting concerns with the large increases in their electricity bills. During the summer and early fall of 2007, three companies announced the closing of paper mills in western Massachusetts, citing the high cost of energy as a reason to close. Layoffs from these closings total approximately 400 jobs. Following these events, WMECo issued a media advisory in November 2007 attributing an approximated $5 million increase in the Company's earnings during the first nine months of 2007 to a settlement that had been reached between former Attorney General Tom Reilly and the Company in October 2006 (the "Settlement"). In response to the above, the Office of the Attorney General Martha Coakley commenced this inquiry to focus on three issues: (i) whether the first nine months of WMECo's 2007 earnings conflict with the terms of the Settlement; (ii) whether increases imposed on large commercial and industrial customers in January of 2007 were appropriate and transparent; and (iii) whether the Company is meeting its transmission upgrade commitments made pursuant to the Settlement.

The Attorney General undertook a comprehensive approach in conducting this inquiry. Attorney General staff discussed rate issues with representatives of large commercial and industrial customers, conducted independent research, as well as reviewed regulatory precedent, applicable statutory law, and all of the Company's compliance and rate filings related to the Settlement. In addition, the Attorney General undertook an independent analysis of WMECo's earnings. Staff also issued oversight questions to the Company in November 2007, and the Company provided responses as required by the terms of the Settlement.

This report presents the analysis and findings of the Attorney General's inquiry. Like all other utilities, WMECo's rates and earnings do not remain constant, and change over time subject to regulatory oversight and treatment, market conditions, among many other factors. The Attorney General's Office will continue to monitor and evaluate the Company's compliance with the Settlement independently, and within rate proceedings before the Massachusetts Department of Public Utilities consistent with routine practice and her obligation to protect the interests of Massachusetts' public utility customers.

II. Major Findings

A. Effect of the Settlement on WMECo's January to September 2007 Earnings

- In 2007, during the months of January to September, WMECo earned a rate of return at approximately 10 percent, which fell well within the range of 8 to 12 percent contemplated by the Settlement.

- Although WMECo issued a media advisory in November 2007 that attributed a reported increase in its earnings of approximately $5 million in the first nine months of 2007 to the Settlement, review of the Settlement revealed that approximately $3.7 million of the increase was the direct result of additional revenue collected from customers as a result of the Settlement.

- Distribution rates, return on prepaid pension costs, and cessation of a customer credit were among the costs that contributed to the increase in WMECo's 2007 January to September earnings. The return on prepaid pension costs and cessation of a customer credit would have likely landed in rates regardless of the Settlement; therefore, WMECo's earnings would have increased with respect to these rate factors regardless of the Settlement.

B. Appropriateness and Transparency of the January 2007 Large Commercial and Industrial Rate Increases

- WMECo's large commercial and industrial customers received average delivery rate increases of approximately 54.7 percent from December 2006 to January 2007. The delivery rate increases led to average total bill increases of approximately 23 to 26 percent for large commercial and industrial customers. Approximately two-thirds of these rate increases were the result of increases in transmission rates, and transition rates, which were independent of the Settlement.

- Despite the fact that the Company met all of its statutory notice requirements, the Company failed to communicate to customers that a number of significant increases were to occur simultaneously on January 1, 2007. The Company made no effort to explain the rate increases until late March 2007 – nearly three months after the rate increases went into effect. At first, the Company provided a misleading explanation for the increase, but later provided a more thorough explanation.

- Going forward, the Attorney General will work with WMECo, other distribution companies, and regulators to ensure transparency in the rate setting process whether through settlement or litigation. Customers should be informed of all proposed rate increases to take effect in a coordinated and comprehensive manner, to ensure customers understand the impact of the overall proposed rate increases.

C. Transmission Project Progress

- The Attorney General will continue to monitor progress of the transmission-related commitments to ensure these projects are completed so that they may relieve congestion costs and enhance reliability in WMECo's service territory.

- The Attorney General remains concerned regarding the Company's compliance with the terms of the Settlement requiring the planning and construction of several projects in the Springfield area.

III. Background

A. The Attorney General's Ratepayer Advocate Function

Massachusetts law imparts a duty to protect the interests of Massachusetts' public utility customers on the Attorney General. She holds specific statutory authority to intervene in both administrative and judicial proceedings "on behalf of Massachusetts consumers in connection with any matter involving the rates, charges, prices or tariffs of an electric, gas, telephone or telegraph company doing business in the Commonwealth and subject to the jurisdiction of the Massachusetts Department of Public Utilities (the "Department") and Department of Telecommunications and Cable."[1]

The Energy and Telecommunications Division carries out the Attorney General's ratepayer protection functions by advocating on behalf of customers in informal and formal administrative proceedings, and court proceedings. The Division intervenes in proceedings to support the interest of Massachusetts' public utility customers. At any given point in time, the Division maintains active involvement in numerous proceedings before administrative regulatory bodies such as the Department of Public Utilities and Department of Telecommunications and Cable,[2] the Federal Energy Regulatory Commission (FERC), and the Federal Communications Commission as well as state and federal courts. Last year alone, the Attorney General's Energy and Telecommunications Division saved utility consumers an estimated $10 million and achieved numerous unquantifiable benefits for consumers through its participation in proceedings on utility matters.

B. Description of the Western Massachusetts Electric Company

WMECo provides electric distribution service to approximately 200,000 customers in 59 communities in western Massachusetts and is an operating subsidiary of Northeast Utilities, a Fortune 500 energy company located in Berlin, Connecticut. Northeast Utilities also owns Connecticut Light and Power, serving approximately 1.1 million electric customers in Connecticut, and Public Service Company of New Hampshire, serving approximately 475,000 electric customers in New Hampshire. The Company operates an electric system of mainly lower-voltage utility wires in western Massachusetts used to deliver electricity to WMECo's customers. WMECo holds a regulated-entity status, making it subject to the general oversight of the Department and obligating it to submit all proposed rate changes and related settlement agreements to the Department for review and approval before the changes become effective.[3]

C. Components of Utility Bills in Massachusetts

In order to understand why WMECo's large commercial and industrial customers received large increases, it is important to understand utility bills in Massachusetts. A typical bill of a customer living or operating a business in Massachusetts contains two parts: the "delivery rate" and the "generation rate." Generally, the delivery rate is one-third of a customer's bill and the generation rate is two-thirds. The delivery rate includes the distribution rates, transition rates, transmission rates and the state program charge.

Customers pay distribution charges for the delivery of electricity to the customer's door over local power and transmission lines and for metering, billing, and other customer services.[4] Distribution rates are subject to Department's sole jurisdiction. If a utility seeks to increase its distribution rates, it must apply to the Department and subject its costs and revenues to regulatory scrutiny in a rate case. The transition charge is the fixed cost associated with the financing and required divestiture of generation property by a utility as required by the 1997 Restructuring Act. These rates recover the costs to utilities of meeting the Restructuring Act's requirements, and resulted from divestiture plans filed, approved, and annually reconciled by the Department. Transmission rates are the costs for the delivery of power over lines from generating facilities across high-voltage lines to where it enters a distribution system.[5] Transmission rates are filed and the actual rate gets approved at FERC. Then the Department oversees the incorporation of these rates into the rate tariffs of the Massachusetts distribution companies. Finally, each customer's bill also carries a fixed charge as set through state statute to fund energy efficiency and renewable energy programs.

The generation charge is for the amount of electricity used by a customer as set by a customer's selected supplier, or, for customers that do not select a supplier, based on the distribution company's basic service rate per kilowatt hour (kWh). These rates are set through contracts and the wholesale electricity market under FERC oversight. Like transmission, the Department oversees the incorporation of these rates into the rate tariffs of the Massachusetts distribution companies.

IV. Overview of the 2006 Settlement

In October 2006, WMECo filed the Settlement with the Department. The Company entered into the Settlement with the Attorney General's Office, Associated Industries of Massachusetts, and Low-Income Energy Affordability Network, in lieu of filing a rate case seeking a $27 million increase. The Settlement applies for two years, January 1, 2007, through December 31, 2008. The signatories agreed to the Settlement in order to mitigate rate increases and maximize customer benefits. Pursuant to key terms of the Settlement, WMECo:

- receives two distribution rate increases, $1 million on January 1, 2007, and an additional $3 million on January 1, 2008; and
- applies a return on equity of 10 percent[6] for certain accounting functions and to calculate its earning sharing mechanism, and if WMECo's earnings exceed 12 percent or fall below 8 percent, it will share 50/50 in the excess or deficiency with customers.

In addition, WMECo is required to:

- implement a reconciling charge for reconciliation of a $10.6 million in pension and retiree health care expense that will be collected in 2007 under the Settlement;
- allocate the revenue increase on an equal cents per kWh basis;
- mitigate transmission rates by crediting approximately a $20 million over-recovery in its transition charge to the transmission under-recovery as of December 31, 2006, to mitigate the effect of the under-recovered transmission costs;
- create a storm reserve fund to help pay for the costs of storm restoration and avoid future rate increases to cover the costs of such restoration;
- make improvements to WMECo's transmission systems designed to reduce or eliminate the need for reliability must run contracts that have cost customers in western Massachusetts approximately $55 million a year;
- fund capital projects designed to improve reliability and safety and allow recovery of the prudently incurred costs of these activities;[7]

- send customers an annual “report card” on service quality performance and submit to a third-party independent audit of annual service quality reporting to ensure accuracy;
- accelerate its tree trimming cycle from a five-year to a four-year cycle;
- submit to the Department’s penalty mechanism for failing to meet service quality standards;
- answer the Attorney General’s oversight questions within 21 days of receiving them; and
- implement a new low-income pilot program expending $200,000 per year in 2007 and 2008.

The Department approved the Settlement on December 14, 2006, after determining that it was consistent with both applicable law and the public interest, and resulted in just and reasonable rates.[8]

V. Analysis

In November 2007, the Attorney General's Office commenced this inquiry focusing on three issues: (i) whether the first nine months of WMECo's 2007 earnings conflict with the terms of the Settlement; (ii) whether increases imposed on large commercial and industrial customers in January 2007 were appropriate and transparent; and (iii) whether the Company is meeting its transmission upgrade commitments. This section outlines the analysis and findings of the Attorney General's inquiry.

On November 5, 2007, Northeast Utilities, WMECo's parent, announced an increase in earnings for the third quarter and attributed the increase to the Settlement. The release provided:

> Western Massachusetts Electric Company's (WMECo) distribution segment earned $4.2 million in the third quarter of 2007 and $13.6 million in the first nine months of 2007, compared with earnings of $2.8 million in the third quarter of 2006 and $8.6 million in the first three quarters of 2006. *Improved 2007 results were due to the impact of WMECo's distribution rate settlement that took effect January 1, 2007.* [Emphasis supplied.]

The Attorney General's inquiry focused on whether WMECo's earnings were within the allowable rate of return under the Settlement given that it only allowed WMECo to earn a reasonable rate of return with in a range of 8 to 12 percent, consistent with statutory law and regulation.

Furthermore, the Attorney General inquired into the appropriateness of the rates paid by large commercial and industrial customers because customers had experienced such large rate increases from December 2006 to January 2007. The sharp rate increases prompted large customers to publicly raise concerns about the magnitude of the rate increases, and the lack of notice of the rate increases. During the summer and in early fall of 2007, three companies announced the closing of paper mills in western Massachusetts, citing the high cost of energy as a reason to close.[9] Layoffs from these closings total approximately 400 jobs.

Finally, an important part of the Settlement was the requirement that WMECo undertake transmission upgrades. These transmission upgrades are needed so that electricity can be brought to western Massachusetts in a more efficient and less costly manner. WMECo submitted reports to the Attorney General in January, July and October 2007, and in January 2008, detailing the Company's progress in executing the transmission projects that it had committed to under the Settlement. As part of this inquiry, the Attorney General reviewed the Company's progress on transmission upgrades, and will continue to review the progress to ensure that customers get the benefits they are entitled to under the Settlement.

The Attorney General undertook a comprehensive approach in conducting this inquiry. To begin the inquiry, the Attorney General issued oversight questions on November 8, 2007, requesting information regarding the effect of the Settlement on the Company's earnings in the first nine months of 2007 and the effect of the Settlement on rates charged to large commercial and industrial customers. On November 29, 2007, WMECo provided responses to the oversight questions of the Attorney General consistent with its obligation under the terms of the Settlement. The Attorney General also undertook an independent analysis of WMECo's earnings. In addition, Attorney General's staff discussed rate issues with representatives of large commercial and industrial customers, conducted independent research, solicited information from the Company regarding earnings and rates, and reviewed regulatory precedent, applicable statutory law, and all of the Company's compliance and rate filings related to the Settlement.

A. WMECo's January to September 2007 Earnings

WMECo explained the effect of the Settlement on its earnings for the first nine months of 2007 in its responses to the Attorney General's oversight questions issued pursuant to the Settlement. The $1 million annual increase in distribution rates, the return on prepaid pension costs, and the cessation of the customer credit related to the refinancing of the prior spent nuclear fuel disposal liability contributed to WMECo's increase in earnings. Together, these three items accounted for an increase of approximately $3.7 million to after-tax income in the first nine months of 2007.

First, as a result of the Settlement, the Company received an authorized increase of $1 million in distribution rates in 2007 and an additional $3 million in 2008; the increases were expected to contribute to the Company's earnings. The Settlement, however, greatly reduced the amount the Company originally sought as a distribution rate increase and tempered the distribution rate impact by phasing in the increase over two years.

Second, the return on prepaid pension costs also contributed to the Company's earnings. These returns are an element of the implementation of the pension adjustment mechanism (PAM) as authorized by the Settlement. This return element increased the PAM rate, and thus the Company's revenues and earnings. Through the PAM, WMECo collects the costs associated with pensions and post-retirement health care for retired employees and carrying charges along with carrying costs. These costs are reconciled annually. In *D.T.E. 03-47*, the Department first approved a PAM for the NSTAR companies, finding that pension and other postretirement benefits were the types of expenses that met the Department standards for such reconciling mechanisms.[10] Prior to this, these costs were included in base distribution rates. Although first authorized for WMECo as a result of the Settlement, there is little doubt that the Department would have approved a PAM as part of a fully litigated rate case.

Third, revenues were also impacted by the cessation of the customer credit related to the refinancing of the prior spent nuclear fuel disposal (PSNF) liability. This change is a direct consequence of the Department's order in Western Massachusetts Electric Company, *D.T.E. 03-82*, and the subsequent refinancing of that liability in 2004. WMECo refinanced the liability by issuing long-term debt. The issuance of long-term debt had the effect of increasing the percentage of long-term debt in the capital structure and thus reducing the Company's weighted overall cost of capital. However, because that reduction to the cost of capital would not be fully reflected in rates until the Company's next distribution rate case, WMECo was ordered to give customers the benefit of the capital cost savings by means of a credit to the transition charge until the next distribution rate case. As of January 1, 2007, distribution rates were deemed to reflect the capital cost savings resulting from the refinancing of the PSNF, and the credit to customers accordingly ceased. The cessation of the credit to customers resulted in an increase to the Company's earnings.

Although the Company provided a complex explanation of the increase in its earnings in its responses to the oversight questions, the 2007 increase in earnings does not, as a general matter, appear to be inconsistent with the Settlement or outside of the Company's authorized rate of return. WMECo identified an increase in net income of at least $3.7 million resulting from the Settlement. The reported increase of $3.7 million appears to be accurate but the increased earnings reflects several factors in addition to the $1 million increase in revenues as a result of the Settlement. Both the PAM and termination of the PSNF credit would have been implemented even in the absence of the Settlement. That is, based upon previous Department orders and precedent, a fully litigated case would have resulted in the same outcome with respect to these items. Any remaining increase in profits can be attributed to the utilization of transition charge over-recovery to mitigate the transmission tracker under-recovery, depending on how the carrying charges are treated for financial reporting purposes, or the remainder could simply be the result of routine fluctuations in revenues and expenses. As WMECo notes in the responses to oversight questions, with the increase in earnings in 2007, the earned return on equity for the year is expected to be around 10 percent, the authorized return in the Settlement. This statement is supported by an independent analysis of the Company's financial statements by the Attorney General's Office.

B. The Appropriateness and Transparency of the Rate Increases on Large Commercial and Industrial Customers in January 2007

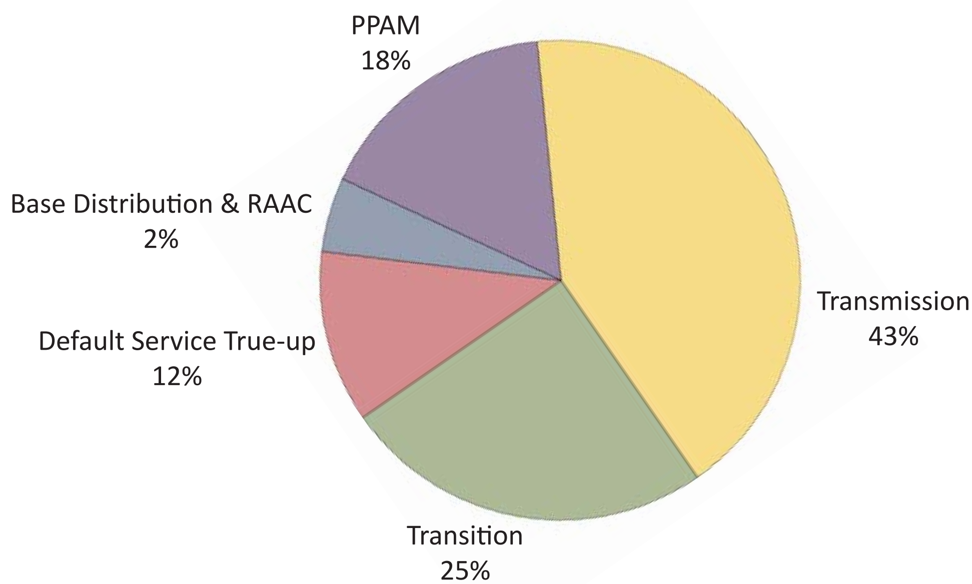
1. The Appropriateness of the Rate Increases

WMECo identified in its response to the oversight questions that the average increase to the delivery rates[11] paid by large commercial and industrial customers from December 2006 to January 2007 was 54.7 percent. This led to average total bill increases of 23 percent to 26 percent for large industrial customers. In interviews with the Attorney General's Office, some large customers reported more dramatic delivery rate increases, as much as 75 percent. Below is a chart that demonstrates how each rate component figures into the 54.7 percent increase that large commercial and industrial customers received from December 2006 to January 2007.

The biggest element of the increase to large customers was the increase in transmission rates of $0.00636 per kWh. The transmission rate increase represents 43.0 percent of the average total increase that large commercial and industrial customers received in delivery rates. Separate transmission rates were first established in association with general restructuring in 1998. The transmission rates were originally unbundled based on cost of service studies. The larger customers generally had lower transmission rates, as well as lower distribution rates, because of economies of scale and higher load factors. Because the present transmission tracker implements annual adjustments on a per kWh basis, any adjustments, up or down, will have a relatively greater percentage impact on the customers with the lower rates, such as the large customers. As set forth above, transmission rates are filed and get approved at FERC.

The transmission rate increase from December 2006 to January 2007 was mainly the result of so-called "Reliability Must Run" (RMR) charges incurred by WMECo in 2006 approved by FERC, which led to a material under-recovery of transmission costs as of December 31, 2006. Western Massachusetts has a notoriously poor transmission infrastructure, which means the region has difficulty importing electricity from other regions. This has led FERC to require four inefficient generators (Con-Ed West Springfield 3, Berkshire Power, Pittsfield/Altresco, and Con-Ed West Springfield GT-1 and GT-2) to run in western Massachusetts for reliability purposes under RMR contracts. These RMR contracts led to additional costs for ratepayers in western Massachusetts

Estimated Contribution of Each Utility Charge to the Average Increase in Rates Experienced by WMECo's Large C&I Customers in January 2007



The chart illustrates how each component of a customers' utility bill contributed to the 54 percent average delivery rate increase experienced by WMECo's large commercial and industrial customers in January 2007.

of $55 million in 2006. This amount is approximately $32 million lower, however, as a result of challenges to these RMR contracts as originally filed with FERC by several parties including the Attorney General's Office. Because of the costly RMRs, WMECo did not recover enough in transmission payments from customers in 2006. Accordingly, the 2007 transmission rates had to be increased substantially in order to make up for the under-recovery as of the end of 2006. The January 2007 transmission rates increased dramatically despite the fact that the Settlement provided that a $20 million over-recovery in the transition rates would be applied to the under-recovery of transmission costs. This transmission rate increase was independent of the Settlement. The percentage increase to transmission rates was higher for large customers because the average transmission rates paid by these customers were previously lower than average and the increase took place as a uniform per kWh charge. The reason that the Attorney General demanded transmission upgrades as part of the Settlement and has been aggressively monitoring these upgrades is to end the practice of costly RMRs.

The next largest element of the increase to large customers is the increase to the transition rate of $0.00374 per kWh. The transition rate increase represents 25.3 percent of the average total increase that large commercial and industrial customers received in their delivery charges. The transition charge was also established in association with restructuring as implemented in 1998. Its purpose was to allow utilities to recover generation-related costs that were deemed at the time to be unrecoverable in a competitive market for generation services.[12] The transition charge has always been recovered on a per kWh basis. The increase in the transition charge from December 2006 to January 2007 was the direct result of the pattern of costs and recoveries in prior years. As of the end of 2004, WMECo had cumulatively over-recovered its transition costs by almost $60 million. In order to reduce the magnitude of this over-recovery, the transition charge in 2005 and 2006 was deliberately set at a rate that was well below the actual recoverable transition costs. By the end of 2006, the magnitude of the over-recovered balance had been substantially reduced, and in 2007, the transition charge was returned to a rate that more closely matched the actual costs, leading to the increase in the transition charge.

Like the transmission charge increase, the transition charge increase would have taken place even in the absence of the Settlement. The increases to the transmission and transition charges together accounted for just over two-thirds, or an estimated 68.3 percent, of the total increase in delivery service rates to the large commercial and industrial customers. As discussed below, the transmission and transition rate increases were approved by the Department in December 2006 subject to further investigation.

The implementation of the PAM increased the large delivery service rates by $0.00261 per kWh, an increase attributable to the Settlement or an estimated 17.6 percent of the total increase in delivery service rates to the large customers. In percentage terms, the increase related to the PAM affected large customers disproportionately because the delivery service rates paid by large customers were lower than average and the increase took place as a uniform per kWh charge. However, the Department, in its order approving the Settlement, explicitly found that implementation of the PAM on a per kWh basis was appropriate and consistent with Department precedent.

The default service true-up increased the large customer delivery service rates by $0.00172 per kWh, or an estimated 11.6 percent, of the total increase in delivery service rates to the large customers. This item appears as a component of distribution rates, but it actually relates to default service, and did not emanate from the Settlement. Finally, the combined net effect of the across-the-board increase to base distribution rates and the shift of recovery of costs associated with the low-income discount from base rates to the Residential Assistance Adjustment Clause (RAAC) resulted in a slight net increase of approximately 2.4 percent to the large customer delivery rates.[13]

2. The Notice in the Proceedings before the Department of Public of Utilities

a. The Notice of the Settlement

WMECo filed the Settlement on October 19, 2006, with the Department of Public Utilities, which ordered the Company to notify customers of the rate changes proposed in the Settlement. Less than a week after the Company made the filing, the Department issued a Notice of Filing (the "Notice of Filing for the Settlement") and ordered the Company to post the Notice of Filing twice in *The Boston Globe* or the *Boston Herald*, *Berkshire Eagle*, and the *Springfield Republican* pursuant to 220 CMR 5.06. The Department also required the Company to give notice of the Settlement to the chairs of the boards of selectmen, town clerks, mayors, and city clerks of each municipality in WMECo's service territory, and to parties that participated in proceeding approving the Company's previous settlement. In addition to other information, the Notice of Filing for the Settlement provided:

> *If the Settlement is approved, the proposed rates in 2007 will result in:*
> - *a residential electric non-heating customers using 500 kWh of electricity per month seeing a $1.89 per month bill increase.*
> - *a residential heating customer using 1,500 kWh of electricity per month seeing a $5.65 per month bill increase.*
>
> Bill impacts for commercial and industrial customers will vary. For specific impacts, please contact the Company as shown below. [Emphasis supplied.]

The Notice of Filing for the Settlement provided for one public hearing on the Settlement that took place on November 20, 2006, at Springfield City Hall. No member of the public participated in the public hearing.

Only a limited number of entities moved to intervene in the proceeding, including NSTAR and Direct Energy, and only one entity, MeadWestvaco, a large industrial user in WMECo's service territory opposed the settlement. The Department approved the Settlement on December 14, 2006, and the Settlement became effective on January 1, 2007.

b. The Notice of the Transmission and Transition Rate Increases

Two-thirds of the delivery rate increases that large commercial users saw from December 2006 to January 2007 came from increases in the transmission and transition rates. These increases resulted from a November 30, 2006, filing with the Department where WMECo filed its request for 2007 transmission and transition rate increases. This filing was made six weeks after the filing of the Settlement and a week after the public hearing on the Settlement. The Notice of Filing for the transmission and transition rate increases provided:

> WMECo proposes an increase of 0.070 cents per kilowatt-hour (kWh) in the Company's transition charge from the current average rate of 0.500 cents per kWh to 0.570 cents per kWh effective January 1, 2007. WMECo also proposes a transmission charge increase of 1.101 cents per KWH from the current average rate of 0.435 cents per KWH to 1.536 cents per KWH.
>
> For residential customers, WMECo's proposal would increase the average residential rate by 1.171 cents per KWH starting January 1, 2007. If WMECo's rate changes are approved, average residential basic service customers using 500 KWH of electricity per month will see their bill increase by $9.17 (or 11.30 percent) per month from $80.91 to $90.08.

The Department ordered the Notice of Filing for the transmission and transition rate increases be sent to any entity that had intervened in the Settlement proceeding. Unlike the Notice of Filing for the Settlement, the Department did not order the Notice of Filing for the transmission and transition rate increases be advertised in the newspapers, or be sent to municipal officials in WMECo's service area nor was there a public hearing in western Massachusetts. The Attorney General intervened in this proceeding on December 19, 2006.[14]

On December 20, 2006, WMECo made an additional compliance filing. This filing detailed the bill impacts from both the effect of the Settlement and the transmission and transition rate increases. This is the first filing that detailed the large increases that were going to come as of January 1, 2007. The December 20, 2006, filing contained a series of charts noting that the significant transmission and transition rate increases would lead to total rate increases of 23 to 26 percent for various classes of customers. This filing was sent to parties that had intervened in the various proceedings before the Department involving WMECo. On December 29, 2006, the Department approved WMECo's filing subject to further investigation and reconciliation. The investigation and reconciliation are still pending final order by the Department.

c. The Notices Failed to Describe the Rate Increases

While the process for the filing and approval of the Settlement and for the transmission and transition rate increases followed Department precedent, the legal notices failed to adequately describe the rate increases that were to come.

Relying on the legal notices as notification to communicate the rate increases is not effective especially for commercial and industrial customers. First, while the notices estimated bill impacts, they only did so for residential customers. Large customers were requested to contact the Company directly for specific bill impacts. Second, the rate estimates provided in the Notice of the Filing of the Settlement were not completely accurate. The Company included the $10.6 million for the funding of the Company's pension fund and retiree health care benefits, the bulk of the 2007 rate increase allowed by the Settlement. The notice, however, failed to estimate costs or bill impacts in connection with this provision of the Settlement. As such, the required statutory notice in this matter does not state the actual size of the increase because it does not take into consideration the increase for pension and retiree health care benefits.

Likewise, the December 7, 2006, Notice of the Filing and the December 29, 2006, Order on the transmission and transition increases did not effectively communicate the impact of the 2007 rate increase to customers. The Notice of the Filing of the transmission and transition increases indicated that rate increases would be approximately nine percent. The December 29, 2006, Order provided details about how rates would be affected by the Settlement and the transmission and transition increases, but provided no overall bill impacts. Only if someone reviewed the details of the December 20, 2006, WMECo filing would they have noted that delivery rates were to increase substantially and the overall rates were increasing 23 to 26 percent.

d. The Company Failed to Inform Customers of the Increases

The Company deserves substantial blame for its failure to inform its customers, especially its large commercial and industrial customers, about the rate increases that were to come in January 2007. As late as December 2006, but probably earlier, the Company understood that its customers, especially its large commercial and industrial customers, were going to receive a substantial rate increase. Despite the Company's understanding, it chose to make no effort to inform its customers about the coming rate increases. WMECo could have, but failed to issue a press release or include a notice with its bills about the pending increase.

Even after WMECo's customers began receiving the increases in early 2007, WMECo remained less than forthright. On March 13, 2007, the *Springfield Republican* published an article entitled "Electricity Rate Increase Draws Mayor's Attention." The article notes that WMECo spokesman, Kenneth Garber, told the *Springfield Republican* that the increases that customers were receiving were the result of the Settlement.[15] As discussed above, this is extremely misleading. Most of the increase came from the transmission and transition increase.

Finally, on March 19, 2007, two and a half months after the increases went into effect, the Company sent a letter to its business customers explaining why the increases took place. WMECo followed this with a much more forthright explanation of the increase in an April 3, 2007, *Springfield Republican* article.

e. Future Rate Increase

In the wake of the large rate increases in January 2007, one of the frustrations that large commercial and industrial customers have expressed is that they did not know the rate increases were coming and they might have had an easier time absorbing the increases with advance notice. Large commercial and industrial ratepayers set their spending budgets at least a year in advance and because many use competitive suppliers, they have a good understanding and can manage the generation portion of their bill. Because the delivery costs generally do not increase as much as they did in January 2007, few, if any, businesses were aware and were able to plan for the increases that came at the beginning of 2007. This meant that large and industrial customers had to change their energy budgets when they began receiving bills in early 2007 and had to make budget cuts in other areas. During the summer and in early fall of 2007, three paper mills in WMECo's service territory, employing a total of 400 people, cited energy costs as a reason that they needed to close.

Although the Attorney General's Office was tracking WMECo's filings with the Department at the end of 2006, the Attorney General's Office did not urge the Company to inform its customers about the coming rate increases. To ensure future transparency in ratemaking and to allow customers to plan, customers should be informed of all proposed rate increases to take effect in a coordinated and comprehensive manner. The Attorney General intends to work with the Department and the companies to ensure that ratepayers receive advance notice of increases and an explanation as to the reasons for the increase.

C. Transmission Project Progress

As part of the Settlement, the Settling Parties agreed to "a plan designed to eliminate wholesale market inefficiencies." WMECO agreed, in consultation with interested stakeholders, "to develop transmission infrastructure improvement projects to address the significant transmission reliability concerns in the western Massachusetts area." As discussed in the earlier section, the poor transmission system in western Massachusetts is part of the reason that customers received large increases at the beginning of 2007. Under the Settlement, WMECo is required to "proceed with due diligence to study, design, and construct" a set of transmission projects known as the "Group One" projects. These projects include:

- Installation of a new 115-kV cable circuit between the East Springfield and Clinton substations;
- Replacement of the East Springfield to Breckwood 115-kV cable circuit;
- Fairmont Substation upgrade/modifications (conversion to a breaker and a half scheme);
- 115-kV transmission lines 1254 and 1723 upgrade/modifications (rebuild by breaking the current three terminal lines and looping in and out of Fairmont Substation and reconductoring);

- 115-kV transmission line 1845 upgrades/modifications (reconductoring); and
- Potential prudent modifications or upgrades to the above advanced Springfield projects or other Springfield area transmission facilities as required by detailed engineering studies.

The Greater Springfield area transmission infrastructure is out dated and operates close its maximum tolerances on peak load days. Under certain contingencies, some transmission lines are expected to exceed well over 200 percent of their capacity.[16] In addition to costing all customers in the western and central Massachusetts zone over $50 million annually to run certain generators to ensure reliability, the Greater Springfield area transmission system is growing increasingly susceptible

to failure if certain generators are unavailable or certain transmission lines fail. While ISO New England Inc. continues to manage reliability concerns, transmission upgrades are necessary. The transmission projects were included in the Settlement to address both cost and the most immediate reliability concerns. The Company's rate increases in 2007 and 2008 are contingent on the Company meeting its transmission obligations.

Influencing the Settlement projects is a three-state, multibillion-dollar, major regional transmission project being pursued by National Grid and Northeast Utilities called the New England East West Solution (NEEWS). The project is intended to address several regional reliability concerns in southern New England and has a Greater Springfield reliability component that will enhance the movement of electricity between Connecticut and Massachusetts. It is anticipated that Northeast Utilities and National Grid will seek formal approvals for the project beginning in mid to late 2008. WMECo has indicated that some of the projects included as part of the Settlement will be impacted by elements of the NEEWS project including coordination of certain projects that will be using the same rights of way. Specifically, the siting of the 115 kV overhead lines is being incorporated into the Greater Springfield Reliability part of the NEEWS project.

On July 3, 2007, WMECo, pursuant to the Settlement,[17] filed its second transmission project status report. The purpose of the status report was to inform the Department and interested parties of the Company's efforts to develop and implement certain transmission projects in accordance with obligations imposed upon the Company by the Settlement. An initial review of the report raised concerns that WMECo was not pursuing some of the required projects. Specifically, the July 3, 2007, Status Report indicated that upgrades to Lines 1254, 1723 and 1845 (collective referred to hereafter as "Springfield 115 kV projects") called for in the Settlement, were not being actively pursued by the Company.

As a result of the concerns, the Attorney General's Office met with the Company for a briefing on the status of the transmission upgrades resulting in a subsequent supplemental progress report being filed on October 4, 2007. In its October 4, 2007, report, the Company addressed the lack of information and progress on the Springfield 115 kV projects. The Company has completed the planning studies for these projects and has achieved Technical Approval from ISO New England Inc. The Company has filed the underground cable projects (East Springfield Substation to Clinton Substation, and East Springfield Substation to Breckwood Substation) with the Energy Facilities Siting Board.[18]

The Company filed its second semi-annual progress report with the Department on January 3, 2008. In this most recent report, the Company reported continuation of the planning and approval process for the Springfield-related projects, including the filing of applications for approval at the Energy Facilities Siting Board. The Company also restated its intent to coordinate the construction of the overhead 115 kV lines in conjunction with the Greater Springfield Reliability Project's 345 kV line.

The Attorney General's Office and other stakeholders will need to carefully monitor the progress of the transmission projects to both ensure that the projects are completed and to prevent redundant investment. While customers should not pay for transmission projects that may be quickly obsolete, the NEEWS project is only in its preliminary stages and will likely take many years to plan, site and build. To the extent that the Settlement projects are cost effective and will be completed far in advance of the NEEWS project, they should be pursued. Most of the upgrades called for as part of the Settlement addressed short-term reliability needs. These projects should remain a priority of the Company.

VI. Conclusion

In approving the Settlement, the Department noted that it relied heavily on the fact that WMECo had represented during the proceeding that it "anticipates filing a general rate case the next time it seeks rate changes pursuant to M.G.L. c. 164, s. 94 (Settlement Article 2.8).[19] The Company's last fully litigated rate case occurred 18 years ago and it appears that ratepayers in WMECo's service territory and the Department, as suggested in the order approving the Settlement, would like to see a WMECo rate case. A rate case will provide a full opportunity to fully investigate WMECo's costs and profits and to set rates based on the findings. The Attorney General would only enter into a settlement if it would be clearly in the best interest of all ratepayers, and after ensuring interested parties have an opportunity to weigh in. If the Attorney General is inclined to reach a settlement with WMECo, it will offer an opportunity to WMECo's ratepayers to weigh in on the settlement ***before*** entering into a settlement. However, ratepayers in WMECo's service territory should be aware that a rate case is unlikely to dramatically lower rates. In fact, a rate case may lead to increased rates and a shift of costs between certain classes of ratepayers in WMECo's service territory, which may mean that certain ratepayers are paying more.

There are other steps that may be more likely to mitigate high rates for WMECo's customers. As discussed in this report, parts of western Massachusetts have poor transmission infrastructure. The Settlement requires WMECo to undertake transmission upgrades to address some of these concerns and ISO New England Inc. is working on other long-term solutions to eliminate congestion and improve transmission efficiencies. While this is likely to be a lengthy process and will have costs, these upgrades should ultimately address transmission constraints and mitigate costs associated with running expensive generators, providing for a more efficient and reliable system.

Similar to the rest of the Commonwealth, electricity rates in western Massachusetts are some of the highest in the country because the New England region relies so heavily on natural gas to meet electric generation needs of its inhabitants. In the long run, the Commonwealth must work towards gaining more fuel diversity and increased use of renewable generation within Massachusetts through establishment of policies that support long term financing for renewable projects and siting reform to ensure such resources can be built in Massachusetts. Further, overall system reliability also requires the consideration of new generating units to replace older, inefficient and costlier units. Clean coal technologies and the safe and sound continued use of the region's nuclear facilities should be considered as part of the solution. These fuel sources and technologies represent the best of very limited options to wean the New England region from its overdependence on natural gas while meeting increasing air quality requirements.

The state should also make it easier for large electricity users to offset their use with on-site, clean generation. Regulatory policies should be put into place to maximize the development of on-site generation for commercial and industrial customers such as combined heat and power systems especially in connection with major new development projects. Clean, on-site generation benefits its owners through enhanced reliability and less need to purchase electricity in the market. The Commonwealth must eliminate remaining barriers to its development, including the establishment of equitable stand-by rates, and consider both financial incentives and penalties for availability and performance of these resources.

The turmoil over WMECo's 2007 rate increases in WMECo's service territory produced some good: Many more customers, especially large customers, have become interested and involved in the rate-setting process. The Attorney General intends to support policies that promote on-site clean generation and fuel diversity and will also work with all ratepayers in the future to ensure that they have opportunities to participate in the rate setting process. Rate transparency appears to have failed in this circumstance and the Attorney General is determined to work with stakeholders, distribution companies, and regulators to ensure transparency in the future.

Endnotes

1. M.G.L. c. 12, s. 11E.

2. Formerly one state agency named the Department of Telecommunications and Energy.

3. M.G.L. c. 164, s. 76.

4. See M.G.L. c. 164, s. 1.

5. Steven Ferrey, The New Rules, 423 PennWell Corp. (2000).

6. The 10 percent rate of return WMECo received is 0.88 lower than NSTAR's rate of return established in a settlement agreement, and 0.025 percent lower than the Department approved for Fitchburg Gas and Electric Company.

7. Capital projects should reduce or eliminate reliability must run costs in the Springfield or Pittsfield areas.

8. *Western Massachusetts Electric Company, D.T.E. 06-55* (December 14, 2006).

9. The closings included Fox River Paper Co. in Great Barrington, MeadWestvaco Paper Co. in Lee, and Schweitzer-Mauduit International's four facilities in Lee and Lenox Dale.

10. The Attorney General opposed the implementation of the PAM in *Commonwealth Electric Company, Cambridge Electric Light Company, and Boston Edison Company, d/b/a NSTAR Electric, and NSTAR Gas Company D.T.E. 03-47*. D.T.E. 03-47, pp. 11-13 (Oct. 2003). The Department has authorized implementation of a PAM for every utility company requesting such authorization since then, generally over the objections of the Attorney General. There is no reason to believe that WMECo would be treated differently, even without the Settlement. Implementing the PAM through the Settlement was consistent with Department precedent and allowed for a significantly smaller increase in overall distribution rates.

11. As discussed above, the "delivery rate" includes the distribution rates, transition rates, transmission rates and the state program charge. In essence, everything except the generation rate. Generally, the delivery rate is one-third of a customer's bill and the generation rate is two-thirds.

12. An example of transition costs includes a utility investment in building and maintaining electric generating plants that they owned prior to the passage of the Restructuring Act of 1997.

13. Base distribution rates actually decreased by approximately 7.5 percent, and the RAAC charge actually increased by approximately 9.9 percent, and netted together, these charges caused an estimated increase in 2.4 percent.

14. In that proceeding, the Attorney General advocated that the Department require the Company to use lower return rates for transition charges and cost of capital on transition charges. See *Western Massachusetts Electric Company, DPU 07-11/-6-105A/06-35* (Attorney General's Initial Brief, pp. 4-9). DPU has not issued a final order, however, if the DPU approves the Attorney General's request, customers would save an estimated $1.817 million.

15. WMECo noted that this statement was not a direct quote from Mr. Garber and that Mr. Garber may have been generally indicating that the Settlement existed.

16. ISO New England Inc. presentation to RC/TC Meeting on January 27, 2006.

17. Settlement Section 2.3 provides:

> In order to assist the Department with its resource planning function and carry out its other obligations under this agreement, the Company shall prepare and file with the Department and the Attorney General a transmission status report. This status report shall detail the progress, including engineering progress, the Company has achieved with respect to the transmission projects identified in article 2.4, below. The status reports will be submitted every six months starting January 3, 2007, and ending two years thereafter.

18. A number of siting-related approvals are necessary; among them are those from the Department of Public Utilities and Energy Facilities Siting Board approval.

19. Settlement Article 2.8 states: "WMECO anticipates filing a general rate case for rates effective, after a six-month suspension period, on January 1, 2009."

Epilogue

After the completion of this report, on May 19, 2008, WMECo filed with the Department for approval of its most recent default service solicitation in which residential customers will see a 6.5-8.1% increase in their total bills. Large commercial and industrial customers on default service will see 26-30% increase in their total bill. However, approximately 83% of large commercial and industrial customers in WMECo's service territory use a competitive supplier and are not impacted by this increase. Review of default service filings by the Attorney General and the Department is limited, focusing primarily on compliance with procurement practices.

While the focus of this report is on increases associated with "delivery charges" in 2007, the most significant driver of overall increases in electricity rates over the past five years for WMECo's, and all other customers in Massachusetts, is in the energy generation portion of the bill. Typically, these changes occur every three months for commercial and industrial customers on default service and every six months for default service residential customers. For those customers that rely on the company for its energy supply or default service (most residential and small commercial and industrial customers), notice of such increases are just as important, if not more, than effective communication regarding delivery charge increases because of their magnitude and frequency.

In connection with its May 19, 2008 filing, the Company has informed the Attorney General's Office that it intends to notify its customers of this increase through public outreach including a press release as well as individual customer service calls to the large commercial and industrial customers subject to the rate increase. Such efforts to notify customers of significant rate increases should be considered a best practice by all the Commonwealth's distribution companies.

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